No. 83-65

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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1983

Leaseway Transportation Corp. and
Raymond J. Rehor,

Petitioners,

v.

United States of America and
James Simeo,

Respondents.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Sixth Circuit

BRIEF OF THE KROGER CO. AS AMICUS CURIAE IN SUPPORT OF AFFIRMANCE

RICHARD L. HUBBARD*
CAROLYN E. AGGER
ROBERT J. JONES
THOMAS D. FULLER
ARNOLD & PORTER
1200 New Hampshire
Ave., N.W.
Washington, D.C.
20036
(202) 872-6700

Attorneys for Amicus
Curiae
The Kroger Co.

*Counsel of Record

QUESTION PRESENTED FOR REVIEW

In a proceeding brought by the Internal Revenue Service to enforce a summons for a corporate taxpayer's internal audit reports, should the courts take into account public policies favoring the confidentiality of such reports?

TABLE OF CONTENTS

Page

Question Presented for Review..... i

Table of Authorities..... iii

Interest of Amicus Curiae..... 2

Summary of Argument..... 3

Argument..... 7

Conclusion..... 20

Appendix..... A-1

TABLE OF AUTHORITIES

CASES: Page

United States v. Arthur Young & Co., 677 F.2d 211 (2d Cir. 1982), cert. granted, 51 U.S.L.W. 3611 (U.S., Feb. 22, 1983) (No. 82-687).....5,10,14

United States v. Coopers & Lybrand, 550 F.2d 615 (10th Cir. 1977).....9

United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982), petition for cert. filed, 51 U.S.L.W. 3400 (U.S., Nov. 23, 1982) (No. 82-716).....11

United States v. Euge, 444 U.S. 710 (1980).....14

United States v. First Chicago Corp., 79-1 U.S.T.C. ¶ 9111 (N.D. Ill. 1978).....16

United States v. Harrington, 388 F.2d 520 (2d Cir. 1968).....15

United States v. Matras, 487 F.2d 1271 (8th Cir. 1973).....9

United States v. Noall, 587 F.2d 123 (2d Cir. 1978).....11

United States v. Powell, 379 U.S. 48 (1964).....8

STATUTES:

26 U.S.C. § 7602.....7,11

26 U.S.C. § 7604.....7

MISCELLANEOUS:

Internal Revenue
Manual, sections 622
and 4024.....13

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INTEREST OF AMICUS CURIAE

The Kroger Co. is a large, publicly held food processing and retailing corporation with its headquarters in Cincinnati, Ohio. Like Petitioner Leaseway Transportation Corp. ("Leaseway"), The Kroger Co. is classified as a "large case" by the Internal Revenue Service (the "Service"), and as such is subject to continual audit by the Service with respect to its federal income tax returns. In the course of these audits, the Service makes numerous requests for the production of documents.

Like most large corporations, The Kroger Co. prepares internal audit reports that are similar in nature to those at issue here. Such reports

are not used in connection with the preparation of tax returns, but are prepared solely for non-tax purposes.

The interest of The Kroger Co. as amicus curiae is to support the petition for writ of certiorari because of the substantial need for guidance and clarification on the scope of the Service's summons power with respect to documents such as internal audit reports. This issue affects The Kroger Co. and all other corporate taxpayers that prepare internal audit reports.

SUMMARY OF ARGUMENT

In recent years, a number of cases have examined the enforceability of summonses issued by the Service directed at documents that are not

prepared in connection with tax returns and contain no primary factual information that is not already available to the Service from the taxpayer's books and records. Such documents include tax pool analyses, proposed budgets, and internal audit reports. These cases are similar in that the Service seeks access to the documents not for the purpose of obtaining factual information, which could be obtained elsewhere, but purely for convenience in the conduct of audits. There are often substantial reasons of public policy for preserving the confidentiality of these documents.

There is a split of authority among the courts as to the proper approach in cases of this type. Some

courts routinely have granted enforcement of the summonses based on a mere possibility that the documents may contain information relating to tax liability, without requiring any showing of particularized need or a reasonable expectation that the documents contain relevant information. Other courts have balanced the Service's need for the documents against the competing policy considerations, and have denied enforcement in appropriate cases. One such case, United States v. Arthur Young (No. 82-687), is now before this Court.

We believe that these cases, including the Leaseway case on internal audit reports, raise fundamental questions about the scope of the Service's summons power and the

appropriate function of the courts in summons enforcement cases. These questions require definitive resolution. The issues will continue to arise in the future with great frequency, since the Internal Revenue Manual used by auditing agents directs the agents to request these documents in many cases.

Amicus believes that where documents of this type are summoned by the Service, courts must consider public policy in deciding whether to grant enforcement. Where public policy considerations in favor of confidentiality are strong, the courts should refuse to enforce the summons, or at least require a more particularized showing of need or an expectation of relevance beyond

that required for the more usual sources of primary factual information.

ARGUMENT

I. THE CONFLICT OF AUTHORITY OVER THE STANDARDS TO BE USED IN DETERMINING THE SCOPE OF THE SERVICE'S SUMMONS POWER OVER DOCUMENTS SUCH AS INTERNAL AUDIT REPORTS MUST BE RESOLVED

Section 7602 of the Internal Revenue Code[1] grants the Service the authority to issue summonses in pursuance of its duties to investigate tax liability and collect taxes. Section 7604 provides a mechanism by which the Service may obtain court enforcement of such summonses in appropriate cases.

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[1] All references to sections, unless otherwise specified, are to the Internal Revenue Code of 1954, as amended, 26 U.S.C. §§ 1 et seq.

It is clear that, before a court will enforce a summons issued by the Service, four threshold showings must be made. It must be shown that the investigation is being conducted pursuant to a legitimate purpose, that the material sought may be relevant to that purpose, that the information is not already in the Service's possession, and that the proper administrative steps have been followed. United States v. Powell, 379 U.S. 48, 57-58 (1964). As discussed below, additional policy factors may also enter into the decision whether to enforce the summons.

The courts have found these standards difficult to apply in cases where the summoned documents are not used in connection with the preparation

of a tax return and contain no data that are not available elsewhere. Some courts have found that the attenuated possible relevance of these documents was outweighed by the need to protect taxpayers from overbroad investigation or by public policies favoring the preservation of the confidentiality of such documents. In United States v. Matras, 487 F.2d 1271 (8th Cir. 1973), for example, the court denied enforcement of a summons for proposed budgets that the Service wished to use as a "road map" in conducting its audit. The court noted that "the government should not, for the mere sake of its convenience, impose unnecessary burdens on a taxpayer in conducting an audit or investigation for tax liability." 487 F.2d at 1275. In United States v.

Coopers & Lybrand, 550 F.2d 615 (10th Cir. 1977), the Service sought a tax pool analysis that contained an estimate of a corporate taxpayer's contingent tax liability. The court denied enforcement, stressing that the document was not used in the preparation of any tax return and that "[m]ere convenience does not make an item producible under an IRS summons." 550 F.2d at 621. In United States v. Arthur Young & Co., 677 F.2d 211 (2d Cir. 1982), cert. granted, 51 U.S.L.W. 3611 (U.S., Feb. 22, 1983) (No. 82-687), the court refused to enforce a summons for a tax pool analysis on the ground that the Service's need for the information was outweighed by the public policy in favor of preserving the confidentiality of communications between corporations and their independent auditors.

Other courts, however, have focused on the literal language of section 7602 that the summons power extends to any material that "may be relevant" to the Service's investigation, and have declined to accord much weight to any competing considerations. In United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982), petition for cert. filed, 51 U.S.L.W. 3400 (U.S., Nov. 23, 1982) (No. 82-716), the court ordered enforcement of a summons for a tax pool analysis, stating that "[w]e are not swayed by the argument that the public policy of the securities laws implicitly overrides the clear grant of summons power to the IRS." 682 F.2d at 544. In United States v. Noall, 587 F.2d 123 (2d Cir. 1978),

the court enforced a summons for internal audit reports, observing that "[w]e are unpersuaded by appellant's argument that enforcement of the summons runs counter to public policy." 587 F.2d at 126.

The internal audit reports at issue here were prepared by Leaseway for purposes unrelated to the filing of its tax returns, and would appear to contain no information not available elsewhere. Their main usefulness in the conduct of a tax audit will be to identify areas in which the Service may wish to concentrate its attention, rather than to supply specific items of factual information. A summons for their production raises the issues that, as discussed above, the courts have found troublesome.

The uncertainty over the proper analysis in these cases needs to be resolved. Issues of this type will continue to arise frequently, because auditing agents are instructed by the Service to request access to documents of this type. See, e.g., Internal Revenue Manual, sections 622 (internal audit reports) and 4024 (tax pool analyses).

II. THE PROPER APPROACH IS TO WEIGH THE SERVICE'S NEED FOR, AND THE DEGREE OF RELEVANCE OF, THE SUMMONED MATERIALS AGAINST THE PUBLIC POLICIES THAT FAVOR PRESERVING CONFIDENTIALITY.

Amicus believes that a balancing approach is required to resolve the problems presented by cases of this type. If enforcement of the summons would conflict with substantial public policies, the court should balance

those policies against the need for enforcement to determine which should prevail. As this Court has stated, the Service's summons authority "should be upheld absent express statutory prohibition or substantial countervailing policies." United States v. Euge, 444 U.S. 710, 711 (1980) (emphasis supplied).

This principle means that even if the four Powell factors are present, the federal courts need not enforce a summons if it is also demonstrated that enforcement would contravene important public policies that outweigh the Service's need for the information sought. In United States v. Arthur Young & Co., supra, the Second Circuit Court of Appeals denied enforcement of a summons despite the District

Court's finding that the four Powell factors had been demonstrated because "the countervailing policies at issue in the case before us require us to fashion protection for the work [of] independent auditors . . ." 677 F.2d at 219.

The balancing approach may require the court to assess the degree of relevance of the summoned material. Case law supports the proposition that a more particularized showing of reasonable expectation is appropriate where the intrusion caused by the summons is great. See, e.g., United States v. Harrington, 388 F.2d 520 (2d Cir. 1968) (summons for records held by third party enforced because showing of high degree of relevance was made); United States v. First

Chicago Corp., 79-1 U.S.T.C. ¶ 9111 (N.D. Ill. 1978) (summons enforcement denied with respect to 15 of 23 internal audit reports because relevance not established). For primary documents such as the taxpayer's books and records, there will ordinarily be little dispute that the information contained therein is highly relevant to tax liability, and there will be no reason to keep the records confidential. For more sensitive documents like tax pool analyses and internal audit reports, however, which are sought for the convenience of the Service in conducting its audit rather than for any raw data they contain, a greater showing of relevance should be required. Rather than accept conclusory assertions that such documents may be relevant to the

examination, the Service should be required to show that it has a particularized need for the specific documents sought, or that it has some concrete indication that the documents are likely to contain relevant information. Such a showing will enable the court to assess the degree to which the Service actually needs the summoned material.

Supplied with this information, the court can then make a reasoned determination whether the summons should be enforced. If the summoned material is highly relevant and there is little reason to preserve its confidentiality, an enforcement order is appropriate. If, on the other hand, the relevance of the materials is slight and substantial policies

favor confidentiality, the court should refuse to order enforcement. The balancing process is the best way in which the competing considerations can be accommodated.

III. SUBSTANTIAL PUBLIC POLICIES MILITATE AGAINST THE ROUTINE DISCLOSURE OF INTERNAL AUDIT REPORTS TO THE INTERNAL REVENUE SERVICE AND THE LOWER COURTS' FAILURE TO CONSIDER THESE POLICIES WAS ERROR

The public policies that favor preservation of the confidentiality of internal audit reports are thoroughly described in the petition for writ of certiorari filed by Leaseway Corp., and we will not reiterate them in detail here. It is clear that the public derives substantial benefit from audit reports that are the result of thorough investigation and candid cooperation; such benefits include

improved compliance with the many complex laws and regulations governing modern business operations, and improved corporate efficiency that creates a more healthy economy. It is likewise clear that these benefits would be jeopardized if the Service were granted routine access to internal audit reports, because a chilling of investigation and cooperation would be the inevitable practical result. Destroying the confidentiality essential to effective internal auditing would interfere with management's ability to monitor the corporation's compliance with the laws, and would therefore raise issues of substantial public concern.

CONCLUSION

This case raises issues of fundamental importance to the administration of the internal revenue laws. Clarification and guidance are needed in determining how conflicting interests in this area are to be resolved. For the reasons set forth above, the Court should issue a writ of certiorari in order to consider these important issues of law and public policy.

Respectfully submitted,

RICHARD L. HUBBARD
CAROLYN E. AGGER
ROBERT J. JONES
THOMAS D. FULLER
ARNOLD & PORTER
1200 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 872-6700

Attorneys for Amicus Curiae
The Kroger Co.

September, 1983

APPENDIX

U.S. Department of Justice
Office of the Solicitor General

Washington, D.C. 20530

September 8, 1983

Thomas D. Fuller, Esq.
Arnold & Porter
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Re: Leaseway Transportation Corp. v. United States, No. 83-65

Dear Mr. Fuller:

As requested in your letter of September 7, 1983, I hereby consent to the filing of a brief amicus curiae on behalf of the Kroger Company.

Sincerely,

Rex E. Lee
Solicitor General

BAKER & HOSTETLER
ATTORNEYS AT LAW
815 CONNECTICUT AVE., N.W.
WASHINGTON, D. C. 20006
(202) 861-1500
TELECOPIER (202) 887-0060

IN CLEVELAND, OHIO
3900 NATIONAL CITY CENTER
CLEVELAND, OHIO 44114
(216) 621-0200
TWX 810 421 8375

IN COLUMBUS, OHIO
65 EAST BROAD STREET
COLUMBUS, OHIO 43215
(614) 228-1541

IN DENVER, COLORADO
600 CAPITOL LIFE CENTER
DENVER, COLORADO 80203
(303) 861-0600

IN ORLANDO, FLORIDA
250 CNA TOWER
ORLANDO, FLORIDA 32801
(305) 841-1111

WRITER'S DIRECT DIAL NO.
(202) 861- 1543

September 7, 1983

Thomas D. Fuller, Esq.
Arnold & Porter
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Re: Leaseway Transportation Corp. and Raymond J. Rehor v. United States of America, Supreme Court No. 83-65

Dear Mr. Fuller:

Counsel for Leaseway Transportation Corp. and Raymond J. Rehor hereby consent to the filing of a brief amicus curiae on behalf of The Kroger Company.

Sincerely,

Marian Pomeroy

HP:nhk
cc: The Honorable Rex E. Lee

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